BEFORE THE STATE BOARD OF TAX APPEALS STATE OF ARIZONA

STATE OF ARIZONA
Bank of America Tower

101 North First Avenue - Suite 2340
Phoenix, Arizona 85003
(602) 528-3966

vs.

ARIZONA DEPARTMENT OF REVENUE,

Appellee.

EDMUND D. and KATHLEEN KAHN,

Appellants,

Docket No. 1824-00-I

NOTICE OF DECISION: FINDINGS OF FACT AND CONCLUSIONS OF LAW

The State Board of Tax Appeals, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follows:

FINDINGS OF FACT

Edmund D. and Kathleen Kahn ("Appellants," with the singular referring to Edmund D. Kahn) were Arizona residents and filed a joint Arizona income tax return for tax year 1996. The return included a \$5,000 subtraction from income for military pension payments made to Appellant from the United States Navy.

Pursuant to an exchange of information agreement with the Internal Revenue Service ("IRS"), the Arizona Department of Revenue (the "Department") learned that the IRS had adjusted Appellants' 1996 federal return. Upon examining the Arizona return for this year, the Department discovered the subtraction claimed for a military pension was double (i.e., \$5,000) the amount expected (i.e., \$2,500). Thereafter, the Department issued an assessment conforming to the IRS adjustment and disallowing the \$5,000 subtraction. After unsuccessfully protesting the assessment to the Department, Appellants now timely appeal to this Board.¹

¹ Mr. Raby, a current member of the Board, recused himself and did not participate in the deliberation or decision concerning this case.

DISCUSSION

The Department does not dispute the fact that the pension income at issue is community property. The issue before the Board is whether Appellants are each entitled to a \$2,500 subtraction for the pension income received solely by Edmund D. Kahn.

A.R.S. § 43-1022(2) provides that "[i]n computing Arizona adjusted gross income, the following amounts shall be subtracted from Arizona gross income: 2. Benefits, annuities and pensions in an amount totaling not more than two thousand five hundred dollars received from one or more of the following:

(a) \dots retired or retainer pay of the uniformed services of the United States \dots "

The Department contends that only Appellant, as a payee of a pension plan, *received* pension income. Therefore, according to the Department, Appellants are entitled to only one subtraction of \$2,500 per tax year.²

The Department cites its administrative regulation A.A.C. R15-2-1022.01, which provides that "[a]n individual is allowed to subtract up to \$2,500.00 per taxable year from Arizona gross income for income received from sources as delineated in A.R.S. § 43-1022(2)(a) and (b) The amount allowed as a subtraction is calculated *per individual*. The allowable subtraction for a married-filing joint return when both spouses receive income from one or more such sources is determined based upon the actual amount of income which is *received by each individual* but not to exceed \$2,500.00 *per individual*." (Emphasis added.)

The Department essentially views Appellants' marital community as a single "individual," where property acquired during the marriage, including the pension at issue, belongs to neither the husband nor the wife, but to the community. However, the definition of the term "individual" under the taxing statutes is "a natural person" and does not include a marital community. See A.R.S. § 43-104(12). Under a more current interpretation of Arizona community property law, Appellants, as individuals — not the marital community — jointly own property acquired during their marriage. See, generally, Mortensen v. Knight, 81 Ariz. 325, 305 P.2d 463 (1956). In previous cases involving the same issue, the Board has

² The Department contends that had Appellants filed separately, each could claim only one half, or \$1,250, of the subtraction per tax year.

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determined that as co-owners of the pension, married individual taxpayers each *receive* the pension; therefore, each is entitled to the \$2,500 subtraction. *See, e.g., Sandell v. Arizona Dep't of Rev.*, No. 1625-96-I (Oct. 14, 1997); *Stewart v. Arizona Dep't of Rev.*, No. 1608-96-I (Oct. 14, 1997).³ Accordingly, the Board concludes that Appellants are entitled to a total \$5,000 subtraction for 1996.

CONCLUSIONS OF LAW

Appellants are each entitled to the \$2,500 subtraction, for a \$5,000 total subtraction, for tax year 1996.

ORDER

THEREFORE, IT IS HEREBY ORDERED that the appeal is upheld and the final order of the Department is vacated.

This decision becomes final upon the expiration of thirty (30) days from receipt, unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

DATED this 27th day of July , 2000.

STATE BOARD OF TAX APPEALS

Stephen P. Linzer, Chairman

SPL:ALW CERTIFIED

Copies of the foregoing mailed or delivered to:

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³ Although the Arizona Tax Court subsequently ruled in favor of the Department on this issue, the non-appealable small claims decision is not judicial precedent and is not authority that binds the Board. *Arizona Dep't of Rev. v. Stewart*, TX97-0066 (Tax Court, 1999).